BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
DIAMOND GARDNER CORPORATION,)
INDIVIDUALLY and AS SUCCESSOR IN)
INTEREST TO GENERAL PACKAGE CORPORATION)

For Appellants: Seymour Lowenstein, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel;
Wilbur F. Lavelle, Assistant Counsel

O P I N I O N

These appeals are made pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Diamond Gardner Corporation, individually and as successor in interest to General Package Corporation, for refund of franchise taxes in the amounts of $9,538.91 and $20,657.26 for the income years 1954 and 1955, respectively, After the appeals were filed respondent made a partial refund of the amount claimed for 1955 on grounds which are not material to the issue on appeal, The claim for that income year is thus reduced to $7,023.43.

The only question before us is whether the transfer of all of its assets by General Package Corporation (hereinafter referred to as General Package) to Diamond Gardner Corporation (hereinafter referred to as Diamond) for stock of Diamond amounted to a reorganization as defined in section 23251 of the Revenue and Taxation Code.

Diamond was organized and exists under the laws of Delaware, has its principal office in New York and is qualified to do and does business in other states including California* Its principal business is producing and distributing matches, molded pulp items, lumber and woodenware products, It also purchases and sells other building materials which are distributed through its lumber yards.

General Package was organized under the laws of Delaware, had its principal office in Illinois and was qualified to do and did business in other states including California. Its principal

business was manufacturing and distributing egg cartons. In addition, it designed and produced mechanized egg packing equipment.

Prior to the acquisition of General Package by Diamond there was no relationship, business or otherwise, between them.

The acquisition came about as follows: On March 7, 1955, the two companies adopted, subject to the approval of their stockholders, a "Plan and Agreement of Reorganization" which provided for the acquisition of General Package's assets in exchange for common stock of Diamond. Diamond agreed to exchange 935,042 shares of its stock for all the properties and assets of General Package, and to assume the liabilities and obligations of General Package, This agreement was approved by the stockholders of General Package on April 26, 1955, and by the stockholders of Diamond on April 28, 1955. The transfer took place on May 31, 1955, and on the same date General Package distributed to its stockholders the stock received from Diamond and dissolved. The stock exchanged by Diamond for the assets of General Package constituted 34.46 percent of its outstanding common stock immediately after the-acquisition.

Shortly after acquisition of the assets of General Package, Diamond sold two parcels of realty included therein. Otherwise it has continued the business without substantial change except for some replacemen of key personnel. Of the eleven directors of Diamond, three had formerly represented General Package.

The pertinent sections of the Revenue and Taxation Code may be summarized as follows:

Section 23332 provides that a corporation is liable for the franchise tax only for the months of a taxable year preceding its dissolution or withdrawal from California, unless the cessation of corporate business was pursuant to a reorganization. Section 23253, subdivision (a) provides that if the business or property of a taxpayer is transferred pursuant to a reorganization, the transferee must include in its net income for computing its franchise tax the net income of the transferor for the entire year in which the reorganization occurred. Section 23251, subdivision (c) defines the term "reorganization" as including a "merger."

General Package has paid the franchise tax for the year 1955, measured by its net income for 1954, and Diamond has paid a tax for 1956 based on the net income of General Package for 1955. If, then, the acquisition by Diamond of the assets of General Package on May 31, 1955, was not a "reorganization" the taxes were erroneously paid, and Diamond is entitled to a refund. The specific question is whether there was a reorganization in the form of a "merger" as the term is used in section 23251.

In the Appeal of Heating Equipment Mfg. Co., Cal. St. Bd. of Equal., Nov. 14, 1960, 3 CCH Cal. Tax Cas. Par. 201-636, 2 P-H State &

Local Tax Serv. Cal. Par. 13234, we held that a merger within the meaning of section 23251 occurred when the taxpayer acquired the stock of two other corporations in exchange for its own stock and thereafter the other corporations distributed their assets to the taxpayer and dissolved. The former stockholders of the dissolved corporations then owned 28 percent of the stock of the taxpayer.

As authority for our conclusion, we relied upon San Joaquin Ginning Co, v. McColgan, 20 Cal. 2d 254 (125 P.2d 36), wherein the California Supreme Court held that a broad interpretation should be given to the word "merger" as used in the predecessor of section 23251 and that federal decisions construing a similar statute were proper guides.

We found from the federal decisions that the primary requisite of a merger is that the former stockholders of the transferor retain a proprietary interest in the transferee. According to the federal cases, this continuing interest must represent a substantial part of the value of the thing transferred and it must be a definite and material interest. It need not, however, constitute or even closely approach a majority or controlling interest. (John A. Nelson Co. v. Helvering, 296 U.S. 374 (80 L.Ed. 281); Helvering v. Minnesota Tea Co., 296 U.S. 378 (80 L.Ed. 284); Miller v. Commissioner, 84 F.2d 415; Putnam v. United States, 149 F.2d 721; John S. Woodard, 30 B.T.A. 1216; 172 A.L.R. 912. Cf. Pinellas Ice & Cold Storage Co. v. Commissioner, 287 U.S. 462 (77 L.Ed. 428); LeTulle v. Scofield, 308 U.S. 415 (84 L.Ed. 355).) In Miller v. Commissioner, supra, the court made the following elaboration:

> In the commonly accepted legal sense, a substantial interest is something more than a merely nominal interest, and in respect to corporations, a definite and material interest is an interest beyond what is usually referred to as represented by "qualifying shares."

Throughout appellant's argument, there nevertheless persists an assumption that a prerequisite of a merger is that the continuing interest of the former stockholders of the transferor be a majority or controlling interest in the transferee.

There is no such overriding difference between the respective purposes of the federal statute and the state statute as to compel us to ignore the holding of the federal cases that the continuing interest need not be a majority or controlling interest. The object of the federal statute was to postpone the taking of gains or losses by virtue of exchanges which give to the old stockholders a continuity of interest in the transferee (C. H. Mead Coal Co, v. Commissioner, 72 F.2d 22), or, to put it another way, exchanges which merely recast the same interests in a different form, (Commissioner v. Estate of Gilmore, 130 F.2d 791.) If the continuity of interest is sufficient to postpone the taking of gains or losses, it may reasonably be said that it is also sufficient to prevent the interruption of franchise tax liability,

But even if the federal cases are ignored, appellant can find no support for its position in the language of the statute. The statute does not state that the word merger as used therein is to be limited in its application to cases in which the stockholders of the transferor obtain control of the transferee. Since a merger commonly involves the absorption of a smaller corporation by a larger corporation with the result that the stockholders of the transferor acquire less than a majority or controlling interest in the transferee, surely, if it were intended, the Legislature would have expressly prescribed the limitation which appellant urges upon us.

Appellant attempts to distinguish the Heating Equipment case on the ground that in appellant's transaction there was no exchange of stock for stock, We specifically recognized in the Heating Equipment appeal, however, that such an exchange was not an essential ingredient of a merger as the term is used in the pertinent statute, Our conclusion in this respect is fully supported by federal decisions. (John A. Nelson Co. v. Helvering, 296 U.S. 374 (80 L.Ed.281); Putnam v. United States, 149 F.2d 721; John s. Woodard, 30 B.T.A. 1216.)

A further claim of appellant, that this was merely a purchase of assets, was also answered in our prior opinion. The transaction is more aptly described as an exchange, but granting that in a sense it constituted a purchase of assets, it was a purchase made with stock pursuant to a plan of reorganization which left the stockholders of the transferor with a continuing proprietary interest in the transferee, This falls within the relevant definition of a merger, (Fisher v. Commissioner, 108 F.2d 707. See also the same case of 34 B.T.A. 1215.) As stated in C.H. Mead Coal Co. v. Commissioner, 72 F.2d 22, 29, the comparable federal statute applies.

> If there is not merely a sale of the assets, but a continuity of interest on the part of the old stockholder in the new business ... and if the transaction partakes of the nature of a merger or consolidation in a liberal view....

As did the taxpayer in the Heating Equipment case, appellant cites Andersen-Carlson Mfg, Co, v. Franchise Tax Board, 132 Cal. App. 2d 825 (283 P.2d 278). There, Andersen-Carlson owed $25,000 to another company, Rome Cable Corporation, The two corporations entered into a contract under which Rome advanced an additional $175,000 and received an option to purchase Andersen-Carlson's assets in exchange for shares of Rome stock and the assumption of Andersen-Carlson's liabilities. A little more than a year later, Rome gave notice of its election to exercise the option and three months thereafter the transfer of title and issuance of stock occurred. Andersen-Carlson was immediately dissolved and the Rome stock, representing about 7 percent of Rome's outstanding shares and worth approximately $270,000, was distributed to the Andersen-Carlson shareholders. The District Court of Appeal concluded that this transaction was not a merger, but a bona fide sale of assets.

In the Heating Equipment case, we distinguished Andersen-Carlson. As stated in Banner Machine Co. v. Routzahn, 107 F.2d 147, cert. denied. 309 U.S. 676 (84 L.Ed. 1021), with respect to the federal statute upon which ours is based, "the statute embraces circumstances 'difficult to delimit'. It follows that cases arising under this statute will necessarily be decided upon their peculiar facts." We regard the facts in the matter before us as analogous with those in the Heating Equipment case and not with the unique circumstances in Andersen-Carlson.

Appellant also argues that we have previously held this transaction to be an "occasional sale" for sales tax purposes, and that consistency demands us to hold that there was no reorganization for franchise tax purposes. Section 6006.5 of the Revenue and Taxation Code, a part of the Sales and Use Tax Law, provides that an "occasional sale" includes a transfer of property "when after such transfer the real or ultimate ownership of such property is substantially similar to that which existed before such transfer." Because the language of that section is totally different from the provision with which we are here concerned, appellant's argument is irrelevant,

Finally, the contention is advanced that section 23251 is unconstitutional if it differentiates between an acquisition of assets for cash and an acquisition of assets in exchange for stock. The differentiation is entirely rational, however, since in one case there is a continuing proprietary interest and in the other there is not.

Based upon the opinion of the California Supreme Court in San Joaquin Ginning Co, v. McColgan, 20 Cal. 2d 254 (125 P.2d 36), upon the federal decisions which that case says are appropriate guides, and upon our holding in the Heating Equipment appeal, we conclude that appellant's claims for refund were properly denied to the extent that they are based upon the issue before us.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of Diamond Gardner Corporation, individually and as successor in interest to General Package Corporation for refund of franchise taxes in the amounts of $9,538.91 and $7,023.43 for the income years 1954 and 1955, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 5th day of February, 1963, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

Richard Nevins, Member

ATTEST: Dixwell L. Pierce, Secretary